Q2 2021

UBP FLEX - BELL GLOBAL EX-ASIA SMID CAP EQUITY

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.

The classification of the Fund(s) as per the Sustainable Finance Disclosure Regulation (SFDR) is available on ubp.com or in the latest prospectus.

Market Comment

- Equity markets continued their rally over the second quarter of 2021, with the MSCI AC World Index adding 7.4% in performance to reach close to 12.5% since the beginning of the year. This rally was supported by the accelerated global roll-out of COVID-19 vaccines and central banks maintaining their accommodative stance. US equities gained 8.2% over the period, while European equities were up close to 6.5% and Emerging Markets 5.0%.
- At the end of June, all sectors of the MSCI AC World Index were in positive territory except for the Utilities sector. The IT and Health Care sectors were the top contributors over Q2. All sectors are also showing strong earnings growth rate expectations.
- The US PMI came in at 60.6 at the end of June, slightly below expectations and lower than the previous print, showing signs of peaking momentum from historically high levels. Alongside strong labour and housing data, US GDP growth for Q1 accelerated and came in at 6.4% qoq, with expectations peaking however for the second half of the year. The global economic recovery could be entering the maturing stage with strong GDP growth, but decreasing momentum expected towards the end of the year along with transitory inflation.
- Concerns over the Delta variant weighed on sentiment and still represent a tail risk for the global recovery, especially in emerging markets, which is clearly reflected in the pronounced underperformance of emerging markets since early March.
- Looking at small and mid-caps (‘SMID’) more specifically, the MSCI World SMID Cap Index was up +5.8% over the second quarter and has now outpaced the broader market by more than 10% since last September. This ongoing outperformance is mainly explained by the better earnings leverage and lower valuation risk characteristics currently inherent in the global SMID cap segment, in comparison to other equity segments which are more expensive today. As an illustration, the 12m forward PE of the MSCI World SMID Cap Index stood at 21x at the end of June, versus 30x for the MSCI World Growth Index.
- In the current context of market expensiveness, global SMID caps are probably one of the last areas within equities where the balance between fundamentals and pricing remains relatively unscathed. This trend, which represents an ideal entry point into the asset class, is set to continue over the next few years.
- In light of the above elements, UBP Flex - Bell Global ex. Asia SMID Cap Equity is well positioned to benefit from a good array of small and mid-cap companies that grow strongly through a cycle along with highly visible revenue streams, strong customer retention and relatively high ESG standards. Their often very established market positions can help them outperform and grow ahead of larger peers by remaining much focused on their niche businesses that are often less susceptible to broader economic fluctuations and market volatility.
- This strategy focuses on pricing power, balance sheet strength and valuation risk, which are some of the most important company attributes for equity investors to consider during periods of rising inflation and higher interest rates.

Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Performance Review

- UBP Flex - Bell Global ex-Asia SMID Cap Equity rallied 8.18% (Class IDq USD, net of fees) over the second quarter of 2021. From a relative perspective, it significantly outperformed the MSCI World SMID Cap Index, which gained 5.78%. Equity markets normalised in the June quarter where companies with strong fundamentals benefitted. This helped drive outperformance of the Fund given the high quality nature of portfolio companies.
- Looking at absolute returns, rotation in the market between value and growth saw a diverse mix within the best performing sectors. Value areas that had lagged performed well, namely Health Care (14% allocation, 4% overweight) and Real Estate (2% allocation, 7% underweight), both of which contributed strongly to returns during the quarter. The strong economic rebound is becoming evident as we see signs of higher inflationary pressures. However, the expectations that these effects will only be transitory meant interest rates stayed low. Investment sentiment therefore became 'risk-on', which benefitted Information Technology (25% allocation, 10% overweight) and Consumer Discretionary (16% allocation, 4% overweight). From a relative perspective, the lack of holdings in the Energy sector (3% of the benchmark) was the largest drag on the portfolio.
- The company that contributed the most to portfolio returns in the second quarter was Poolcorp which rose 33% in the quarter (2.5% position, +78bps contribution). The company is the leading supplier of pool chemicals and accessories in the US. As consumers have been spending more time around the home, their investment in maintaining and improving their pools has increased. Additionally, industry supply chain bottlenecks hurt smaller pool supply companies and resulted in Poolcorp gaining additional market share and pricing power. The positive effects were quantified in the recent results which came in 90% above expectations. With a strong backlog of business, management recently reiterated their expectations for 6-8% sales growth in FY22. The investment team continues to see good upside through continued sales growth and also margin expansion.
- Another significant contributor to returns was Yeti (2.3% position, +58bps contribution), which rallied 27% over the last three months. The company continues to expand its brand value and product assortment driving repeat purchases by consumers. Yeti also continues its successful international expansion, which resulted in sales growing 42% year-on-year. The company is also getting strong operating leverage with margins improving to 18% as consumers purchase more products online, combined with a concerted effort to reduce unnecessary costs in the supply chain. This resulted in operating profit growing around 140% compared to last year. Here again, the investment team sees ample opportunity for strong sales growth at Yeti and continued operating leverage over the next few years.
- The biggest detractor during the period was Danish single-use endoscope manufacturer Ambu (1.3% position, -27bps contribution). Their products continue to take significant share in the market, but the share price declined after they delayed the introduction of a key new product.
- Other detractors were relatively small, all falling less than 5%. These included: IT software platform company Enghouse Systems (2.6% position, -9bps contribution), corporate payment and fuel card provider FleetCor (2.0% position, -7bps contribution), and specialty consumer company Church & Dwight (2.9% position, -6bps contribution).

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Portfolio Activity

- The portfolio remained relatively fully invested during the quarter, holding on average around 2.6% cash over the period. Cash levels are expected to remain around these levels; however and considering the exuberant market conditions, the team expects to continue trimming expensive names and reallocating the cash to names that have lagged and where valuation is more attractive.
- From a trading perspective and given the strength in equity markets, the focus was on finding good value in high quality stocks. The most interesting is Euronext, which was recently added to the portfolio and is trading on a below-market P/E ratio. This pan-European exchange has grown strongly with increased trading volumes and IPO's this year. Euronext's growing FX and commodity businesses have provided an additional leg to organic growth. The higher levels of activity flows into additional revenue generation in data sales and post trade clearing and custody services. The catalyst at this point is the merger with Borsa Italiana, which should strengthen the market share in many existing verticals.
- The other new name bought into the Fund in the quarter was Keysight Technologies. The company is the market leader in electronic and network design, testing and measurement solutions used primarily by R&D engineers. It is a beneficiary of the continued strong demand for semiconductors. The rollout and upgrades of cellular networks and continued innovation in the smartphone industry have been significant long term drivers and provide a stable base to Keysight's revenue as the industry invests in 'next generation' platforms. The proliferation of electronics through the automotive industry, the automation of industrial processes and the use of electronics in other IoT solutions is also growing their addressable market. The combination of these factors should drive high-single digit sales growth. With double-digit EPS growth and the potential for valuation expansion as investors realise the positive industry tailwinds, the investment team sees over 40% upside over the next few years.
- There were various other names where the position sizes were increased during the quarter including Rightmove, the UK based online real estate portal, which should continue to benefit from strong housing market trends. The team also saw attractive valuations in some companies that had recently lagged including Canadian telco Rogers, security tech company Check Point Software Technologies, industrial equipment auctioneer Ritchie Brothers, and Canadian software platform company Enghouse Systems.
- There were two companies sold from the portfolio during the quarter, both for valuation reasons. Swiss dental implant and clear aligner company Straumann became excessively expensive after a rebound in dental procedures that pushed the stock up well over 50% since inception of the Fund. The team also exited Avery Dennison, the US based label and RFID manufacturer. The company's valuation has risen after achieving margin expansion and 15% EPS growth over the past four years, beating their 10% growth target. At this juncture, the team believed the 22x P/E was elevated, especially considering the potential downside risk since the company is likely to face input cost headwinds due to the inflationary environment.
- There were various other names that were reduced over the quarter, the most notable were O'Reilly Automotive and Partners Group, both of which reported exceptionally strong results. The team continues to hold them as key positions; however, their upside should be more limited in the near term.
- From a sector allocation perspective, the most preferred sectors remain Information Technology (27% allocation), where the team has added new names. Consumer Discretionary remains significant (15% allocation) as does Health Care (14% allocation) although it was reduced slightly with the exit of some names that reached their price targets.

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- In terms of least preferred sectors, the portfolio continues to have no exposure to Utilities or Energy. From a relative perspective, the largest underweight sectors remain Real Estate (7% underweight) and Financials (5% underweight).
- From a regional/country perspective, the largest allocation remained to North America and was relatively stable with the US at 54% and Canada at 11%. The allocation to Europe remained diversified with the largest allocations being 8% to the UK and 5% to Denmark.
- At the end of June, the portfolio's top 5 positions were Rightmove (3.5%), CGI (3.2%), Ritchie Brothers (3.1%), Euronext (3.1%) and ICON (3.0%).

Outlook

- Strong economic data and the momentum of the recovery have been a key driver of equity markets this quarter and with no doubt shall provide continued support. This was evident in the exceptionally strong March quarter reporting period, which saw the average earnings result beat expectations by over 20%. The stellar performance of the market since the drawdown in March 2020 has seen the MSCI World Index rally 93% and the MSCI SMID Cap Index rally 113% (all in USD).
- At this juncture, the investment team believes the June quarter earnings period should also be very strong; however, they balance their constructive outlook by recognising the potential risks from higher valuations and cost related headwinds, which may dampen medium term expectations.
- Cost related headwinds are a common issue heard from companies that the team has spoken to over recent months. Inflationary headwinds are beginning to flow through to input prices due to stubbornly high commodity prices. The recovery is also resulting in labour shortages and wage inflation. Thirdly, the rapid rebound in demand has caught many manufacturing companies by surprise resulting in supply chain bottlenecks.
- Valuation multiples are again becoming stretched in pockets of the markets, as expectations of interest rate hikes have been tempered. This is particularly evident in growth stocks where the valuation premium relative to the broader developed equity markets indices looks stretched.
- With many countries still in the early days of re-opening, the investment team sees the potential for continued economic growth and higher corporate profits. They balance their enthusiasm by remaining disciplined on valuation to reduce the risk of capital losses if bouts of market volatility return. With a focus on high quality franchises at reasonable valuations, the portfolio is well balanced to perform favourably in these conditions.

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